



**THE ATTORNEY GENERAL
OF TEXAS**

AUSTIN 11, TEXAS

**JOHN BEN SHEPPERD
ATTORNEY GENERAL**

April 14, 1955

Honorable Allan Shivers
Governor of Texas
State Capitol
Austin, Texas

Letter Opinion Number MS-199

Re: House Bill 16, the Texas
Business Corporation Act

Dear Governor Shivers:

You have asked for our opinion as to the constitutionality and "effect" of House Bill 16, and whether it will create a "hiatus" in the Texas laws dealing with corporations.

The question of constitutionality is clear cut and can be answered squarely, and we shall endeavor to do our best in dealing with the broad possibilities of the questions of "effect" and "hiatus".

There has been no change in the corporation laws of this State except piecemeal additions or changes applicable to specific types of corporations since 1874. At that time, of course, the legislators, as well as the public generally, were unaware of the important role that the corporate method of doing business would play in the economy of this State. Thus, the need for modernization of the Texas corporation laws has been painfully realized for many years by business men and by lawyers engaged in serving them. Text writers have been emphasizing the need of corporate revision for many years. See 1 Hildebrand, Texas Corporations, 160; Belsheim, 27 Texas Law Review, 659. In 1950 Secretary of State Shepperd, the administrator of the corporation laws at that time, made many speeches pointing out the need for revising our archaic corporation laws to take care of an expanding modern economy.

Since 1950 much, of course, has been done by many segments of the business and legal profession toward accomplishing a sound revision of the Texas corporation laws. Much thorough and painstaking work has been done by various legislative committees. For five years a special committee of the State Bar made up of corporation law professors, lawyers experienced in the administration of the corporation laws, and outstanding practicing corporation lawyers have worked unceasingly for such revision.

The Texas Legislature is specifically authorized under Article XII, Section 2, of the Texas Constitution to enact general laws for the creation of private corporations and to provide for the adequate protection of the public and the individual stockholders. The Constitution further provides that no corporation shall issue stock or bonds except for money paid, labor done, or property actually received. Texas Constitution, Article XII, Section 6.

After careful consideration of the contents of House Bill 16, we are unable to find any provision violative of the Texas Constitution. It is our opinion that the Legislature has fully complied with the constitutional requirements calling for the adequate protection of the public and of the individual stockholders. The Act meets the constitutional limitation as to what may constitute consideration for the issuance of stock and bonds. In the exact language of the Constitution itself, the Act provides that "The consideration paid for the issuance of the shares shall consist of money paid, labor done, or property actually received." Art. 2.16.

The caption of House Bill 16 is fully adequate to secure notice of the subject, nature, and content of the Bill, and thereby complies with the mandatory provision of the Texas Constitution, Article III, Section 35.

It is our opinion that House Bill 16 is constitutional in all respects.

The "effect" of the Texas Business Corporation Act will be to introduce a few new concepts, ideas and principles of corporate existence into Texas law which have heretofore been impossible, to settle certain questions of corporate existence and law over which there has been considerable conflict, and to codify long standing principles of Texas case law. Due to the vastness of the project, we will not attempt to show the effect of each and every Article of the Act, but will point out only certain items which we feel to be salient features.

With certain exceptions, the Act provides that a corporation organized for profit may be organized for any lawful purpose or purposes, which purpose shall be fully stated in the articles of incorporation. Art. 2.01. This is a fundamental change in Texas corporate law and policy. A corporation may be organized for any purpose not forbidden by law, and for as many different purposes as desired. This provision eliminates entirely the doctrine of limited corporate purposes and places Texas in accord with the policies of forty-six other states of the United States. This provision will also eliminate the objection that many investors have had in that they were afraid to incorporate under the Texas law, particularly when they contemplated doing business in other states.

Article 2.04 of the Act provides that the lack of capacity of the corporation shall never be made the basis of any claim or defense in law or in equity. Thus, a corporation may never claim the defense of "ultra vires" in any proceeding in which it is involved. However, the doctrine still rightfully maintains its vitality in quo warranto proceedings by the State.

The Act provides for the increased protection of the integrity of invested capital. Under the present law the original investment in the technical incorporation has been subject to the scrutiny of the Secretary of State, but those in control of the corporation can easily cause it to

dilute the investment or destroy its integrity by the purchase of assets or shares of stock or other processes of stock-watering which are not under the scrutiny of any public official. This Act adopts a "good faith rule" relative to these subsequent transactions. Art. 2.21. It prohibits payment of dividends or purchase of the corporation's own shares except out of unrestricted surplus, Art. 2.38 and 2.03B; and expressly makes clear that the wronged corporation and others adversely affected will have a right of action against the parties causing this wrongful dilution of capital. Art. 2.41.

The right of ownership of land continues to be limited as is now the case. The integrity of the so-called "pipeline divorcement act" is still maintained.

The Act does not apply to all corporations. However, all corporations will be governed either by this Act or by some other applicable corporation statute. It specifically excludes, under Article 9.14, corporations organized for the purpose of operating banks, trust companies, building and loan associations or companies, insurance companies of every type or character that operate under the insurance laws of this State, corporate attorneys in fact for reciprocal or inter-insurance exchanges, railroad companies, cemetery companies, cooperatives or limited cooperative associations, labor unions, abstract and title insurance companies operating under the Insurance Code of this State, corporations organized for the purpose of operating non-profit institutions, including but not limited to those devoted to a charitable, benevolent, religious, patriotic, civic, cultural, missionary, educational, scientific, social, fraternal, athletic, or esthetic purposes. However, if the special statutes under which the excepted corporations are organized provide that the general corporation laws shall supplement the provisions of such special statutes, then the provisions of the Corporation Act shall apply to the extent that they are not inconsistent with the provisions of such special statutes.

The Act further provides that any special limitations, obligations, liabilities, and powers applicable to any particular kind of corporation for which special provision is made by the existing laws of the State shall continue to be applicable to any such corporation, and the Act does not repeal such special provisions. Art. 9.15. Under existing law, many special statutes are applicable to corporations coming within the scope of this Act. Under this provision of the Act, these statutes relating to such matters as the regulation of public utilities, etc., are not repealed. Those corporations to which the special statutes apply will be subject to the provisions of this Act except where there is a conflict between this Act and the special statute. Where conflict arises, the special statute will be controlling. Art. 9.15.

Under Article 9.14 domestic and foreign corporations existing and doing business within the State on the effective date of the Act are given a period of five years within which to comply with the provisions of the Act. During this five year period existing corporations may continue

to operate under the present corporation laws or they may voluntarily elect to adopt the provisions of the Act. Upon the expiration of the five year period after the effective date of the Act, this Act shall apply to all corporations transacting business in this State within the contemplation of this Act. They shall be deemed to have elected to adopt the provisions of the Act by not voluntarily dissolving or withdrawing from the State. Thus, this provision merely provides a five year interim during which an existing corporation may at its option continue to operate under the statutes heretofore applicable to it rather than to adopt the new Act. Hence, the former corporation laws are made effective for five years as to existing corporations not adopting the Act, as well as continuing to govern all corporations outside the scope of the Act. All new corporations coming into being after the effective date of the Act must be formed under its provisions.

Articles 5.01 through 5.06 provide the procedure for consolidation or merger of domestic corporations, shareholder approval for a merger or consolidation, and the effect of merger or consolidation. The Act makes clear that merger and consolidation are permissible for all types of corporations within the scope of the Act. The Act further makes a clear distinction between merger and consolidation, and between those proceedings and the sale of all its assets by a corporation, and further provides for the consolidation of a domestic corporation with a foreign corporation, and vice versa. Article 5.07. These provisions fill a much needed gap in the present Texas corporation laws.

The Act further clarifies the powers of the corporation and its right to invest in other corporations, Article 2.02; it defines certain financial terms, Article 1.02; it clarifies the classes and categories of types of shares that may be issued, Article 2.12; the Act sets forth the procedure for voting shares of stock, Article 2.29; it provides certain classifications and liabilities of directors, Article 2.33, 2.41; it authorizes the use of the executive committee, Article 2.36; the Act protects the rights and sets forth the powers of dissenting stockholders, Articles 5.12 - 5.14; it distinguishes between voluntary and involuntary dissolution proceedings, Articles 6.01 - 7.03; it provides for receiverships, Article 7.04; and provides for amendments to the articles of incorporation, Article 4.01. All these references are excellent examples of clear cut guideposts that corporate management and the shareholders can follow and on which a lawyer can give competent advice instead of having to rely on surmise and conjecture. Your inquiry raises the question of the "effect" of this Act on other laws dealing with corporations. While many other laws affect and regulate various activities of corporations (e.g., the oil and gas conservation statutes affect oil drilling activities of both individuals and corporations), the only other laws dealing with corporations which it appears this Act will affect are the statutes dealing with corporate franchise taxes.

Under the present franchise tax statutes, Article 7084, et seq., Vernon's Annotated Civil Statutes, a corporation's franchise tax is measured by, inter alia, its "outstanding capital stock." This is a vague and

ambiguous concept which has been replaced by the more exact concept of "stated capital" used and clearly defined in this Act.

Also under the present provisions of the franchise tax statutes, a discrimination against domestic corporations in favor of foreign corporations results from the fact that a foreign corporation's initial tax is not due and payable until one year and ninety days after the granting of a permit, while a domestic corporation must pay a tax immediately upon incorporation based on its "outstanding capital stock" as of the date of incorporation. This can and has resulted in unfairness to the State in some instances and unfairness to particular domestic corporations in others, e.g., a domestic corporation may organize with a small amount of invested capital, pay a relatively small franchise tax, then borrow a large amount of capital on a long term basis, and then start actual business operations; it would not be until its next franchise tax due date which might be as much as a year and ninety days that such borrowed capital would be reflected in the corporation's taxable capital and the State would have forever lost, or at least not collected the franchise tax attributable to such borrowed capital during such initial period. To state a converse example, a domestic corporation might organize with a relatively large amount of "authorized" capital stock, but not actually obtain all of it until a year or two later. It would, nevertheless, have to pay a franchise tax measured by the total amount "authorized", even though less than that was actually utilized in pursuit of the business conducted in the State.

The new Act, in line with the great majority of the other states, permits the creation of a corporate entity without any capital being paid in at that point in time. A safeguard for the benefit of creditors is, however, provided by the prohibition similar to that in a majority of the other states that at least \$1,000.00, or 10% of the total capitalization, whichever is greater, be paid in before commencing business.

It is our understanding that an amendment is now pending to House Bill 660 which will alleviate any possible franchise tax problems and this tax discrimination against domestic corporations.

We are unable to see that a "hiatus" will be created in the Texas laws dealing with corporations as a result of House Bill 16 being signed into law. Those corporations not specifically exempted from its provisions will be governed by the provisions of this Act. Those exempted corporations will be governed by the special laws relating to them. Those particular types of business corporations which have special statutory provisions relating to them under existing laws will be governed under the provisions of this Act except where there is a conflict between the Act and the special statutory provisions, and where there is such a conflict the statute will prevail.

In summary, it is our considered opinion that House Bill 16, the Texas Business Corporation Act, is in all respects constitutional. It will

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have the effect of clarifying and in some instances changing the Texas laws relating to business corporations, but no hiatus in the administration and functioning of the corporation laws is foreseen by its passage.

Yours very truly,

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By


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